DOW THEORY LETTERS INC.

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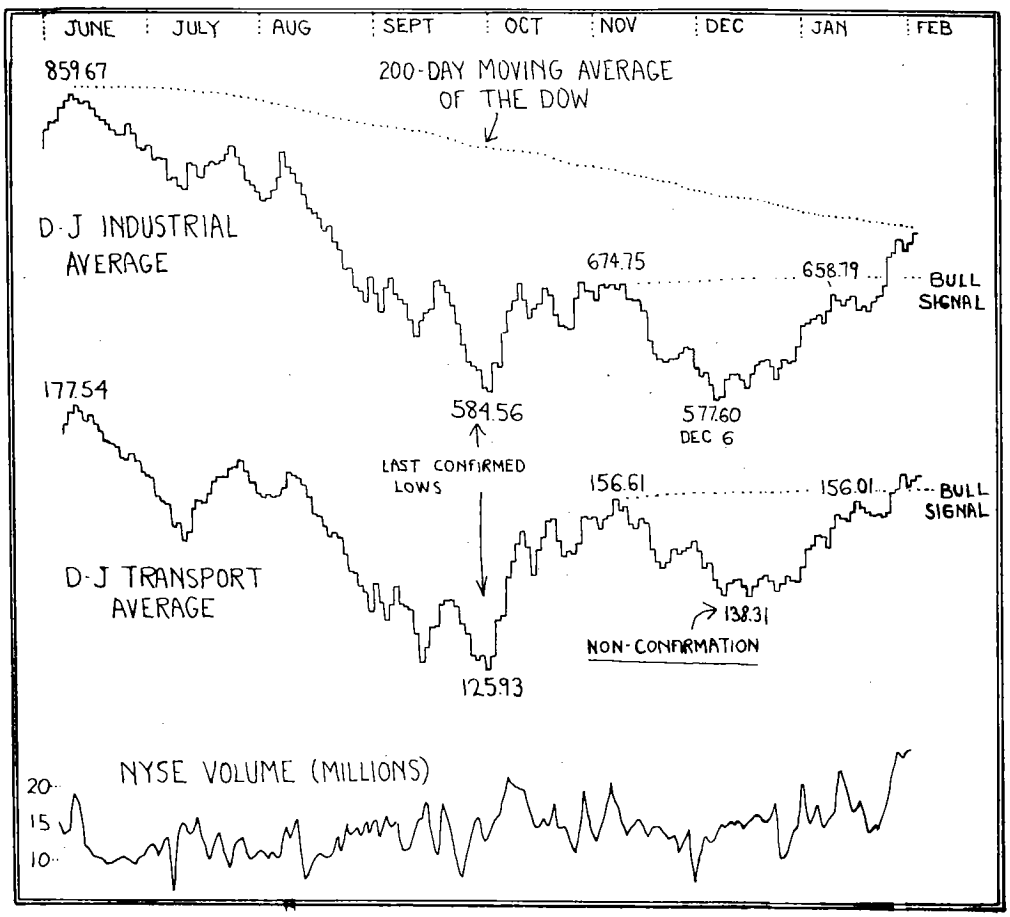
"Everything returns, I learned from the river that everything returns." From Siddhartha by Herman Hesse.

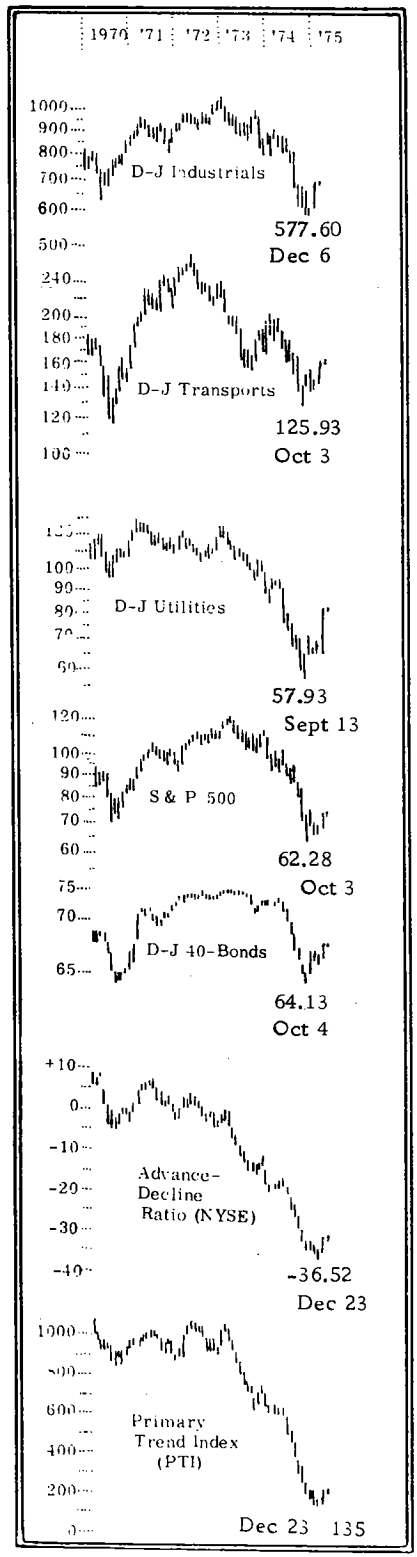
BULL MARKET: On January 27, 1975, the D-J Industrial and Transportation Averages closed above their preceding peaks of 674.75 and 156.61. On the method put forth by Charles H. Dow at the turn of the century, the joint penetrations by the two Averages confirm what we have already suspected. We have been in a primary bull market since October 3, 1974.

The manner of the bull confirmation was the most spectacular of any in stock market history. On January 27, the Dow Industrials rose 26.05 points to close at 692.66. On the same day the Dow Transports advanced 3.60 points to close at 156.79. All-time record volume of 32.1 million shares accompanied the move.

I had stated in Letter 619 (January 15) that the closer in time the penetration of the two Averages, the more valid the primary signal. Validity, I added, would be further increased if volume rose on the penetrations. The fact that the bull market was confirmed by simultaneous penetrations of the two Averages on record volume lent great validity to the January 27 signal.

Nothing of this kind has been seen in any of the primary bull signals in modern history. Neither 1921-29 nor any of the bull markets that followed had such auspicious beginnings. The 1932-37 bull market was confirmed by the Averages with a span between the penetration of





 Industrials and Transports of 14 days. The 1942-46 bull market had a four month span between penetrations of the Averages. The 1949-66 bull market had a three month span.

What does it mean that the January 27, 1975 signal came with such astounding force? My own guess fits in with the picture of the advance-decline ratio as shown in Letter 619, page 5. That study noted that the advance-decline ratio had been in an 18-year bear market, a massive decline in NYSE issues that began in 1956. This great collapse in the majority of NYSE issues (and, of course, in all the issues on other exchanges) was unparalleled in market annals. At the 1974 bottom (as I stated in Letter 619) the unweighted average of NYSE issues had dropped 77%, only 12% less than the record 89% drop of 1929-32! It was my opinion that by late-1974 the stock market had discounted every bearish possibility short of the collapse of Western Civilization.

It is axiomatic that when the market discounts the worst, it has no place to go — but up. The figures, the prices, the values, the prevailing black psychology, all suggested that the worst had been fully discounted during October-December, 1974. On December 20, 1974 I sent out my Special Report saying that the time had come to buy. The Report went out while the Dow was within 21 points of its extreme low. Among my reasons for saying "Buy" were the following: The bear market had entered into its third or final phase, stocks, hundreds of them, were selling below known values. Dividends of 10% to 12% were rampant as were P/E ratios of 2 and 3. The equities of many great corporations were literally selling at 10¢ on the dollar. And finally, the Averages and indicators were saying that the market was exhausted on the downside.

The primary bull signal of January 27 confirmed that we were correct in our assumptions and in our buying. I believe that the power of the bull market signal (confirmation) stemmed from the urgency experienced by informed investors as they swarmed in to sop up the fantastic values being offered. The market, in its mysterious wisdom, realized that the worst had been discounted. The tide had turned up, and like a great sleeping colossus, the bull lifted its head while pouring forth hundreds of millions of dollars into the market.

Question: Russell, how does this market advance differ from the ones that began in 1966 or 1970? What's the big deal here? Answer: People forget (if indeed they ever knew) that Dow's Theory deals first and foremost with values. It is during the third phase of a bear market that stocks go down to the real value basis — or below it. I based a great deal of my arguments in recent Letters on the principle of value. It is only in the third or final phase (when the worst has been discounted in the price structure) that the tide is ready to turn up. That is what we saw in 1974. That is why the 1975 primary bull signal is different from anything that happened in 1966 or 1970. That is why I stated that it is valid and that a primary bull market is now in progress.

Question: OK, Russell, if you think everything is so great, why not get 100% invested in common stocks now? Why did you say up to 33% invested prior to the bull signal and then add another 25% after the bull signal? What are you scared of? Answer: A good question. No picture is ever perfect. No bull market beginning looks perfect, no bull top is ever a text-book cinch. Nothing is exactly the way we'd like it on Wall Street. If it were, then every damn fool with a "How To Buy Stocks" paperback could make a fortune. It just doesn't work that way. A lot of problems have not been solved here in 1975. The debt problem has not been solved. Inflation has not been solved. I'm human, and I worry. That's why I say tops 60% invested now. But I'm not kidding myself. I may say 80% or 100% a few months from now. I also have a conservative bent. (I'm sure I would have said the same thing in 1921 or at the start of every other bull market, so you have to allow for my psychological defects.)

Question: I don't blame you for worrying, Russell. You're just having one of your saner moments. I don't think this market has discounted half of the troubles that are coming up. Answer: OK, I'll go over this crucial point once again. I've tried to drill into my readers' heads (and this goes for all my readers, regardless of whether you're a fund manager, a corporate president or a market analyst) that the market's function is to discount, to look ahead. The big argument put forth by the pessimists runs something like this: "Boy oh boy, when the stock market finds out what I know about the economy, is it going to collapse! Yeah, you're going to see that Dow around 250." If that's the way you think, my friend, grab your nest egg, get out of Wall Street, stay away from the stock market, don't even pause as you walk past your local brokerage office. You're on your way to joining that vast army of losers in the stock market.

No, the stock market represents the sum total of everything that is known by anybody. Millionaires stay up nights puzzling over their favorite companies, financial geniuses grill the Treasurers of leading corporations, steely-brained accountants pour over the latest company reports, astrologers, Senators, doctors, lawyers, Arab Sheiks, presidents, dictators, butchers, bakers, they all vote with their money when it comes to Wall Street. All of which makes the market the greatest repository of knowledge, intuition, brains and power ever to descend on the financial world. That's Wall Street. And you think you know more than it does?

You say the stocks won't hold up if we get dividend cuts and lousy earnings reports ahead? All right, here's a practical test. Count the new lows we get from here on. Watch stocks that show poor earnings or cut their dividends and see if they go to new lows. If they don't, then the worst has been discounted. I don't know of a better test.

You still don't really believe the market can discount the best — or the worst? You still don't believe that the Averages know more than any man or group of men? Recently James D. Fullerton, Chairman of the Investment Company Institute, described the end of the terrible bear market of 1937-1942. "On April 28, 1942 in the gloomy environment, in the midst of a war we were losing, faced with excess-profits taxes and wage and price controls, shortages of gas and rubber and other critical materials and with the virtual certainty in the minds of everyone that once the war was over, we'd face a post-war depression, in that environment the market turned around.

"There was no selling climax. There was no resolution of the serious problems and uncertainties that faced the country and the world. There was no piece of significant good news. In fact, all the news was bad and continued bad for a long, long time. The war continued for three more years. But the bear market petered out."

Could there be any greater test of the market's mysterious ability to discount the trend of events? Do we have any greater testiment to the uncanny ability of the Averages to see ahead? That is why I always tell people, "When you get a primary bull signal in the midst of seeming disaster, never act on the thesis that 'the market is wrong or crazy' because it doesn't see what you see. It is far better to act on the thesis that you are the one who is missing the picture, that you aren't able to understand what the market is telling you."

I don't know how many times I've told subscribers to stop wringing their hands and fretting about "Why?" In these reports we concentrate on "How" the market works, not why. In the great majority of instances, the real reasons for a move are not known in advance, and often they are never known. Those who demand to know why the market is going up will find that they almost always buy or sell when the action is over and the movement is about to reverse. These are the reasons why it is so hard to buy right and sell right. Because when you are buying correctly the reasons are not clear, the situation looks awful, and your emotions will be screaming that you are wong. In fact, I have two adages that may help the newcomers at this point (1) "A bull market always climbs a wall of worry." (2) "If you're not sweating, you're not buying right."

Question: What do you make of this huge volume right off the lows? Isn't this dangerous for your so-called new bull market? Answer: Maybe, but it has happened before. In June and early July, 1932 the Dow was in the low 40's with volume dragging at half a million shares a day. On July 8 the tide turned bullish, following the worst collapse in history. Between July 8 and September 7, 1932 the Dow rose 92% to the tune of 4-5 million shares a day. What had happened? Investors realized that the worst had been discounted and that stocks were selling at unbelievable bargain prices. They surged in to buy those bargains.

BULL MARKETS: Most primary bull markets develop three recognizable psychological phases (these should not be confused with price movements). The first phase represents the bounce up from the depressed levels of the preceding bear market bottom. Here stocks move back to a more realistic value level (from their area "below known values"). We should be in the first phase of the bull market now.

The second phase of a bull market is the one wherein stocks advance as they reflect improving conditions for business, and these improvements should occur in the economic, social and political sphere. The second phase is usually the longest phase. It is also the most deceptive.

The third phase of a bull market is the speculative phase, and here the public participates on an increasing scale. The third phase is marked by heavy volume, rumors, hot tips, standing-room-only lines at the back of the brokerage office and a general euphoria based on the thesis that "the New Era has finally arrived".

I don't know whether this bull market will oblige us by conforming to classical standards and expectations. I don't know whether this bull market will last a year and take the Dow to 850 or whether it will last five years and take the Dow to 3,000. I don't have the vaguest idea, and I'll let you in on a very valuable secret. There isn't a man on the face of this green earth who does know where we're going. Not a one! I know that millions of man hours and tons of paper are expended by analysts and self-styled experts, all dedicated to telling people just how far the market is or is not going — and on which day and hour the advance (or decline) will end. But there is only one axiom that has withstood the test of time. It is this: NEITHER THE DURATION NOR THE EXTENT OF A PRIMARY SWING CAN BE PREDICTED IN ADVANCE.

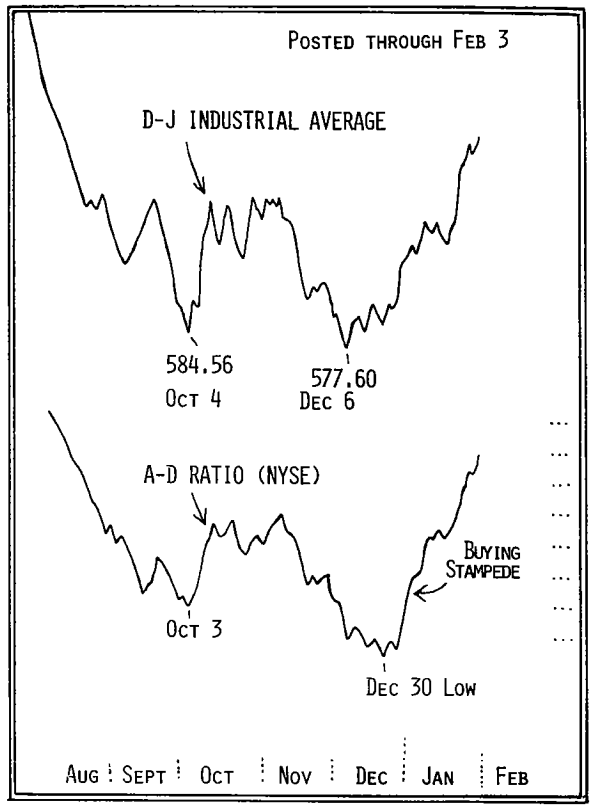
As a point of interest, I might add here that I have never (in thirty years of watching Wall Street) seen so little publicity given to a confirmed Dow Theory bull market. A reporter from a local business paper called me last week and asked me what I thought of "this advance." I answered, "Advance, hell, this is a bona fide bull market, not just an advance." Only Business Week (February 10, page 22) of the major publications called it the way it is, following an interview with the writer. Time and Newsweek have avoided the words "bull market" like the plague. I take all this avoidance as being bullish. I believe that the great majority of Wall Street and everyone else thinks we are in some sort of a freaky blow-off, and they don't want to tempt the public with the phrase, "bull market."

BREADTH: In Letter 619 I described the characteristics of a "breadth stampede," and I stated that this bull market was now enveloped in one. The breadth stampede is a phenomenon wherein the A-D ratio (representative of the advancing or declining trend in the majority of issues) continues up day after day, week after week. A study of past history tells us two important things about breadth stampedes. One, they usually appear early in bull markets. Two, they tend to come in series, usually a series of three. An individual stampede may last for months.

Basic lesson: The A-D ratio is figured as follows. Let's say we have an advancing day with 1100 issues up 400 down, and 1800 issues traded in total (300 issues were unchanged). We subtract 400 from 1100 and divide by issues traded or 1800. This gives us a figure of .388 which I round off to .39. We add .39 to the previous day's total. In other words, plus.39 is the A-D ratio reading for the day. On a declining day, we figure the statistics the same way but subtract the daily tabulation from the running total.

As of this writing, Wall Street is in a continuing breadth stampede, a stampede that began (see chart next page) on December 31. The stampede is the result of persistent, powerful buying. I will consider the stampede to be intact as long as all declines halt less than 1 point from their highest preceding A-D point.

For instance, if we have two big down days and we take off .51 on one day and .52 on the next, this would be just over 1 point. I would then consider the stampede (or at least the first phase of the stampede) over. This has not yet occurred, and I include a daily chart of the Dow and the A-D ratio so that subscribers can study the remarkable buying or breadth stampede that has ushered in the year 1975. (Note: graduations at right of chart are 1 point each).

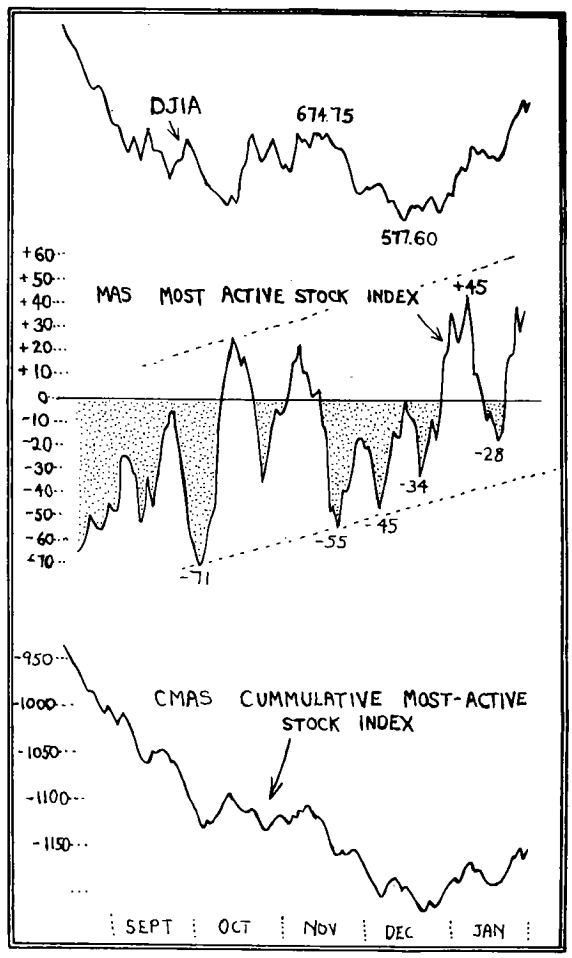


MOST ACTIVES: This is a study that I have reviewed periodically over the years. It is based on the plurality of advances or declines in the 15 most-active stocks daily on the NYSE. For instance, if on a given day 10 stocks were up, 3 were down and 2 were unchanged, we would get a plus 7. I put these daily pluralities on an 8-day moving average, and this is MAS or the most-active stock index.

I also run a cumulative total of the daily most-active pluralities, and this can be likened to a daily advance-decline index of the most-active pluralities. The cumulative index appears as CMAS on the chart.

What is the significance of the most-active stocks? The 15 most-active comprise up to 30% of total daily volume on the NYSE. The most-active also tend to pin-point "where the big money goes." Past experience shows that when money is pouring into the most-actives on the upside, the market tends to follow on the upside. In other words, a rising trend in the most-actives indicates big money or informed accumulation. The contrary is true when the most-actives are moving down as far as daily pluralities are concerned. Such action indicates distribution or informed money moving towards the exits.

In view of this, the recent action of MAS and CMAS is worth studying. Note on the MAS that we have been moving up in a broad, rising channel. The channel is shown by the dotted lines on the chart. Note also that since late-September the trend has been to lower minus figures and higher plus figures. This indicates shrinking distribution on the declines, increasing accumulation on the advances. The January 10 figure of plus 45, in fact, was the highest plus reading in 10 months.



Turning to the CMAS, which is cumulative, we see a head-and-shoulders bottom effect with an upside breakout last week, the strongest pattern I have seen in this indicator in 17 months. My conclusion is that the most-active stocks have been heavily bought by informed money over the past five months. This, of course, is a decided plus for the market.

NOTES: The Standard & Poor's broad 425 Industrials Average closed the month of January at 85.63. This is far above the 77.0 mark discussed in the last Letter. The long decline in market momentum (that began in 1971) has now reversed sharply to the upside. Study the momentum chart in Letter 620, page 4. Draw in the latest momentum rise to the 80 level. This should be the beginning of a major move in market momentum.

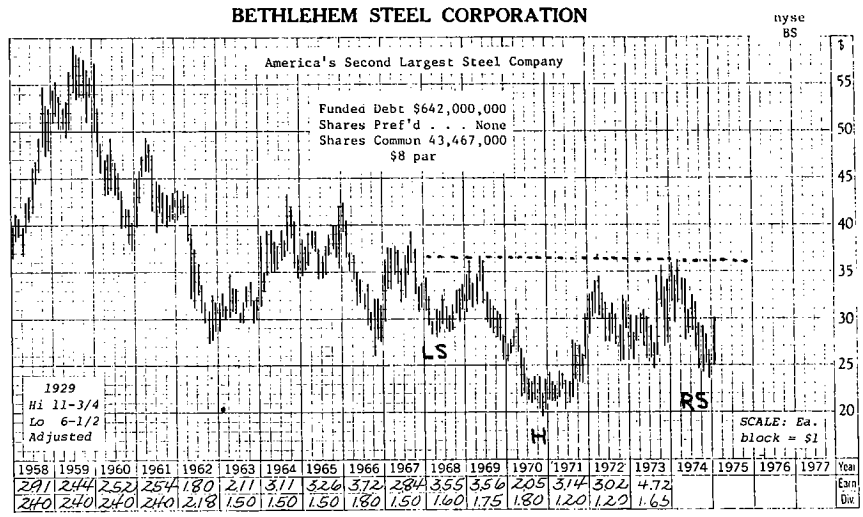
The month of January (and thanks to Yale Hirsch of Stock Market Almanac fame for this data) is a bellwether month, if we judge from history. As January goes, so goes the rest of the year, at least 85% of the time. Over the past 25 years we have had January changes in the broad S & P Average ranging from plus 7.6% during 1967 (the best performance) to minus 7.6% in 1970 (the worst). Of the 15 plus Januarys, only one (1966) gave way to a minus year in the market. Of the 10 minus Januarys, 7 led to minus years in the market as a whole. Of the top January gainers in the S & P 500, 1967 was the first with plus 7.6%, 1961 was next with 6.3%, and 1951 was third with plus 6.1%.

Now comes January, 1975 with a fantastic gain of 12.3% for the month, an all-time record. January, 1975 also saw the greatest gain in Dow points (87.45) of any month in stock market history. The previous top three Januarys (1951, 1961, 1967) produced S & P 500 gains for the year of 16.%%, 23.1% and 20.1% respectively for an average gain of 19.9%. Conclusion: 1975 has every chance of being a good year on Wall Street.

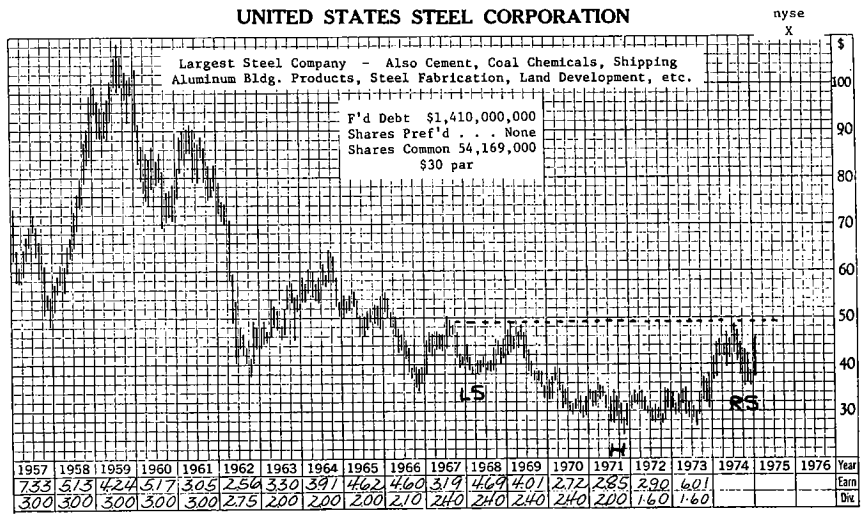
I keep the chart of the weekly advance-decline pluralities, tabulated in the form of a 30-week moving average. This chart provided a long-term profile of the advancing or declining trend of NYSE issues. The index peaked in March, 1971 at 30,700, then formed a long series of lower peaks, finally plunged to a figure of 6,200. The index turned up in October, 1974. Last week it reversed its entire three-year decline. We are having (and should continue to have) an historic upward stampede in breadth.

For the latest week ending January 31, I note that 17 out of the 20 most active stocks for the week ended up, only 2 down and 1 unchanged. Just as interesting, 7 out of the 20 most actives were stocks in the Dow Industrials. My conclusion is that it was "good" buying.

STOCKS: If you want to make money in a bull market, you have to buy stocks. The great percentage moves usually come during the first third of a bull market, and this is also the safest part of a bull market (although it feels least safe). You think the news is too bad now and you're afraid to buy stocks? You want to wait until the New York Times says "it's getting better?" The bad news is the reason why stocks are cheap today. It's the reason why J. P. Stevens is selling today at one-third of book value and yielding 10%. It's the reason why US Steel is selling at 4.5 times latest reported earnings.



One group that has been basing and consolidating for years is the Steels. Now brace yourself, you readers who have never seen a real upside market boom. There's nothing on Wall Street like a Steel market. When the big Steels go, you can "feel" the bull tide come in. We haven't had a real Steel market since 1958-59, but I think one is coming up. When it comes in, it's going to sweep in mass bullishness, because steel is still one of the great backbones of the nation and the world.



Steels topped out in mid-1959, and they continued down for over a decade. Most brokers on Wall Street today don't know what a Steel market looks like. I can tell you, it's spectacular. Why do I think we're going to have a Steel market? Two reasons: First, this is the first bona fide primary bull market since 1949-66, and I can't believe we'll get through it without the Steels' putting on a show. Second, the charts indicate to me that Steels have been under massive accumulation and are getting ready to move up. I include charts of Bethlehem and US Steel, the two Dow Steel stocks. Both are in giant head-and-shoulders bottoms; powerful, accumulation formations. The charts are marked LS (left shoulder), H (head) and RS (right shoulder) showing the classic configuration of the head-and-shoulder bottom.

The relative strength (RS) of the Steel group turned down in 1960, and it continued down for twelve years until 1972. A double bottom in RS occurred during 1972-73 and from then on RS in the Steel group has been climbing. The long decline in Steel RS means, however, that this once great group is now thoroughly sold out. For twelve years steel stockholders have watched their stocks act worse than the market, and the steel stockholders became increasingly disgusted and they sold out. But now RS in the Steels has turned up, and Steels are beginning to outperform the market. Note on the charts that US Steel actually held above its 1973 low during the 1974 crash year. This is real strength, although few people noticed it. As a point of interest, US Steel is one of only seven (non-gold) NYSE issues that gained in price in both 1973 and 1974!

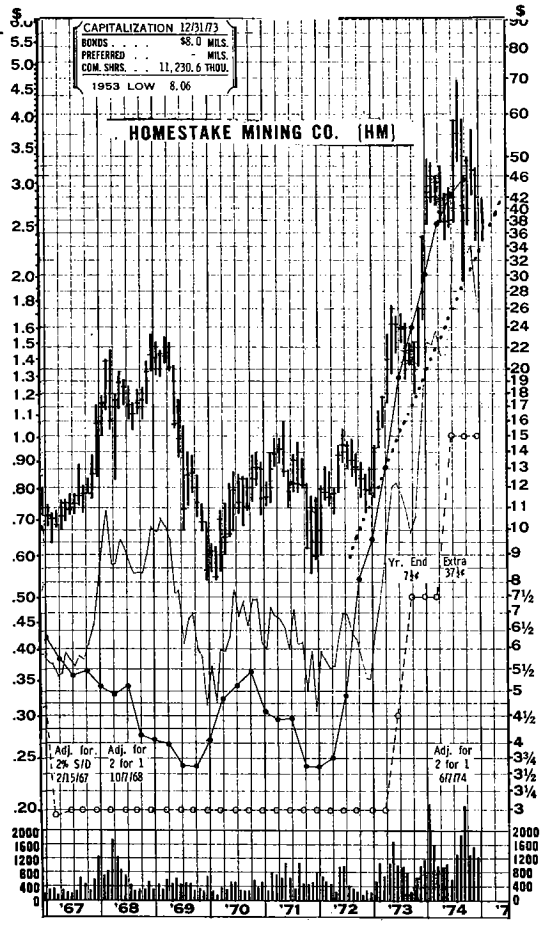
Which steels do I like? My suggestion is that you buy the big one — US Steel. If you want to own more than one, I would suggest Inland or Armco. Interestingly, the American steel companies can now compete successfully with most foreign steel outfits. The President of US Steel recently stated that foreign steel shipped into the US last year cost users $1.5 billion more than if they had purchased the metal at the US Steel Corp.

So in general, the American steel companies have had their 10-year baptism of fire, they have melted a lot of fat off, and they are now in good shape. US Steel has the added advantage of having large cement and coal interests. I feel that before 1975 is over,

US Steel and the steel industry as a whole will again be recognized as one of the nation's great, backbone industries. (Charts of X, BS courtesy of Horsey, Salisbury, MD 21801.)

A subscriber just wrote me complaining that I had recommended GAF and by the time he got my Letter the stock was 9½. My answer is this: I'm not recommending stocks for a quick trade, I'm talking about a primary bull market. If you have to think in terms of whether you should buy Monday or Tuesday or at the opening or 1/4 point lower at noon, then you shouldn't be reading this report. I don't offer a trading service, and I don't advocate trading for my readers. If you have a compulsion to trade, my advice is that you buy a seat on the NYSE and make a real business out of trading. Non-floor members can't hope to compete with professional traders, and I seldom meet anyone who has made money in his trading over any considerable length of time.

GOLDS: Most of my subscribers (on my repeated suggestion) have cut back substantially in their gold holdings. Others have sold out completely. Few own more than 12% in gold shares, 12% in gold coins, as per my advice. I would own no more than that. With the money freed from the sale of gold shares, many readers now have substantial profits in stocks which they purchased since December. Some stocks that I recommended such as General Cinema and Melville Shoe are up over 100% since late-December. Almost all have made substantial moves. The point is to get with the bull trend, and this should have nothing to do with our emotions. If the only primary bull trend was US commemorative postage stamps or African trading beads, I would probably steer my subscribers towards those markets. It's as cold and unemotional as that.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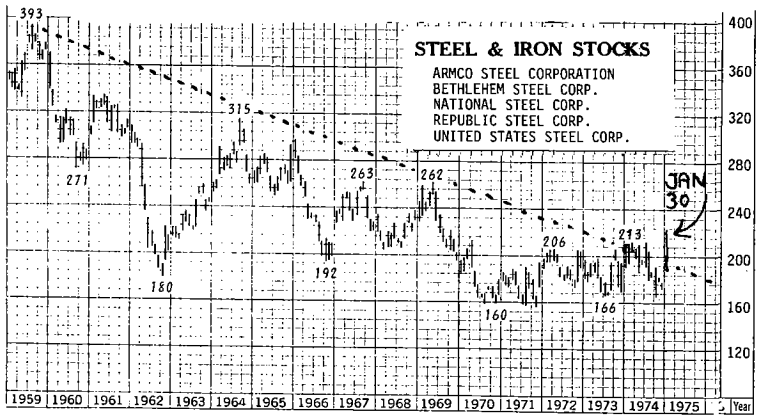
The accompanying chart of bellwether Homestake may tell us the story of gold over the foreseeable future. This is a monthly ratio chart, courtesy of Security Research, 208 Newbury St., Boston MA 82116. I have drawn the trendline that traces the 1971-74 phase of the gold bull market, a bull market which I believe began in late-1969. As you can see, HM is riding right on the trendline, and a break below 33 would take HM through the line on the downside. I would say that any closing under the 1974 low of 29½ would suggest that gold shares in general are in a bear trend of possible primary significance.

If this happens, don't ask me why. I don't know, except that the market would be telling us that gold's time has not yet come. Do I think golds would still be a hold if HM breaks 29? Personally, I would not want to be in them except perhaps in a token way in a few of the best-yielding S. African issues. How long could a bear market in golds last? My guess would be that it would last a year or so, but this is just a guess.

Would I recommend getting back into golds again? If the situation warrants, and the technical picture looked right, you bet I would. But I am opposed to riding out a situation that could materialize into a primary bear market, and there is that possibility in golds. As far as the bullion (or coins) are concerned, my gold momentum chart has turned decisively down with the latest reading on the 13-week momentum being 106. This means that gold is only 106% of its price of 13 weeks ago. If momentum drops under 100, and I feel that it very well may, we would have a rather bearish gold situation. That situation could merely reflect short-term supply and demand factors, or it could represent something more fundamental.

My guess is that in time I will be back in golds along with my readers, but I do not think the time is now. I will keep subscribers abreast of my readings on the gold picture, be assured of that. But in the meantime, I feel the bull market is in other-than-gold shares, and that's where I am, and that's where I want my subscribers. What more can I say?

LATE NOTE: We haven't had a "New High" in any of Barron's 34 industry groups in I don't know when. But this Horsey monthly chart of the Steel Group is telling us that a massive turnaround and breakout is here. Last week Barron's Steel Group pushed over the 212 level to its highest reading since 1969. Quietly, the great Steel accumulation shown in the previous charts has accomplished its work.



Will-Go (see Letter 618, page 4) is calling for a market reaction around the end of February or in early March. The correction could last a few weeks to a month or longer. Remember, every primary advance is subject to the normal one-third to two-thirds correction. The last advance started from the December 6 Dow low of 577.60.